

Bolz, Klaus; Pissulla, Petra

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GATT's Role in East-West Trade

by Klaus Bolz and Petra Pissulla, Hamburg*

After a phase of stagnation in East-West trade lasting several years, both sides have more recently been at pains to intensify economic relations between East and West, the reasons being both economic and political. What part can the General Agreement on Tariffs and Trade (GATT) play in this regard?

The General Agreement on Tariffs and Trade (GATT) perceives itself as an instrument for liberalising trade between its member countries and protecting the degree of liberalisation achieved. The aims of GATT are to increase continually the real interchange of goods via an as great as possible liberalisation of trade relations, and thus to make an important contribution to increasing real income and maintaining full employment. With these aims as a backdrop, one could theoretically expect all the socialist countries of Eastern Europe to have sought membership of GATT over the course of time – particularly in the wake of détente policies and their increased Western orientation in trade.¹

Socialist Member Countries

In fact, only Czechoslovakia (founder member), Poland (1967), Romania (1971), Hungary (1973) and Bulgaria have successfully made use of the opportunity also available to socialist countries of becoming a member or (in Bulgaria's case) an official observer of GATT. It was only possible for GATT to agree to admit these state-trading countries – if it wanted to avoid undermining or even abandoning its own market-oriented principles and rules of play, thus jeopardising for the future its undisputed achievements on behalf of world trade – on the proviso that special rulings appropriate to each country in turn were drawn up and agreed to.

When it comes to including state-trading countries with foreign trade monopolies in the General Agreement on Tariffs and Trade, problems automatically arise, primarily from two closely connected principles determining relationships between GATT members. One of these is the principle of non-discrimination

among trading parties, which is a main pillar of the agreement, and is expressed in the most-favoured-nation clause; the other is the fundamental principle of reciprocity, i.e. trading parties mutually conceding to particular conditions which, though it is not mentioned outright in the articles of GATT, is nonetheless of fundamental significance for how the agreement is viewed by its signatories and how it functions in practice.² In concrete terms, if a socialist country wishes to join GATT two difficulties are faced which are barely soluble:

□ The General Agreement on Tariffs and Trade works on the underlying assumption that quantitative import restrictions are prohibited (concessions are made only in the exceptional circumstance of a country facing serious balance-of-payments problems). One would expect it to be difficult, however, for a planned-economy system incorporating a state monopoly on foreign trade to put a convincing case that it would not, in GATT's terms, be permanently in breach of the prohibition of quantitative import restrictions.

□ According to the most-favoured-nation principle any new member of GATT can rest assured that it will be able to export its goods to its fellow member countries at the currently prevailing rates of duty within GATT. The problem arising with regard to socialist countries, though, is that in the majority of them customs duties in the sense in which they are understood by GATT do not

¹ Cf. K. Bolz and B. Kunze: *Wirtschaftsbeziehungen zwischen Ost und West – Handel und Kooperation*, Part III/3, Bonn 1972, p. 44 ff.

² On this question, cf. in particular the very systematically composed contribution by H. Gröner: *Zur Meistbegünstigungsgewährung durch Staatshandelsländer – Die Frage der GATT-Mitgliedschaft von RGW-Ländern*, in: A. Schüller and U. Wagner (eds.): *Außenwirtschaftspolitik und Stabilisierung von Wirtschaftssystemen*, Stuttgart, New York 1980, p. 40 ff.

* HWWA-Institut für Wirtschaftsforschung-Hamburg.

actually exist. Thus, in its strictest sense, the principle of reciprocity cannot be applied, for the new members would be unable to offer any tariff reductions as a *quid pro quo* for the preferential tariffs offered within GATT (and even if the socialist country concerned did have a tariff which it could reduce to the GATT level, if we take the first problem into consideration it still might not guarantee that the other GATT members received equivalent benefits).

Regulations So Far Agreed

Because, apart from Hungary, the countries seeking GATT membership were not in a position to reciprocate the benefits they would receive under the most-favoured-nation clause by themselves offering customs duty benefits – indeed this was ruled out on formal grounds alone – their adoption as GATT member countries had to be preceded by an agreement on special entry conditions which would stimulate trade.³ Poland, in 1967, pledged that it would increase its imports from GATT members at an annual rate of 7 %, thus achieving an effect similar to a tariff reduction. In 1977, Romania declared its willingness to expand imports from GATT countries at at least the same rate as its total imports. Only Hungary, when it joined the organisation in 1973, was deemed in the light of the far-reaching economic reforms it had carried out to have a functioning system of customs duties and, accordingly, it became a member of GATT on the basis of mutual tariff reductions. Nevertheless, the deeds of accession for all three countries contain clauses giving other GATT members the right to protect their economies from any damage which might arise from trading with a state-trading country by means of non-tariff measures, notably quantitative import restrictions. This accession clause is very closely connected with the way in which individual CMEA countries determine prices. As this is largely an administrative process and the final price does not necessarily reflect the costs of manufacture, GATT's intention was to range effective defensive measures against exports made at dumping prices. The latter also applied to Czechoslovakia even though as a founder member of GATT it really ought not to have been subject to such special rulings.

Even if the socialist countries in GATT are not in a position to grant most-favoured-nation treatment to their fellow members (this, incidentally, applies equally to socialist countries amongst themselves), the solutions offered as an equivalent do also have a stimulatory

effect on trade and are therefore in accordance with GATT's general aims and objects. In fact, the obligations Poland and Romania have entered into ought to encourage those managing their economies to see that the most-favoured-nation status now granted by written agreement – it had previously also been granted *de facto* – is effectively used to generate more exports. Taking a global view, the additional exports thus facilitated represent a funding basis for the countries' own import increases to which they have agreed. The significance of most-favoured-nation treatment in stimulating trade became apparent to no small degree in 1982 when the USA suspended such treatment towards Poland, hitting hard at Polish exports to the US market.

Reticence by Soviet Union and GDR

The fact that the Soviet Union and the German Democratic Republic have still made no application to become members of GATT certainly cannot be explained in terms of their having no "equivalent" favourable conditions to offer GATT partners as a contractual concession in return for most-favoured-nation status. What would, however, appear to be of key significance is that the United States, being Moscow's chief adversary whether politically, ideologically, militarily or economically, is not prepared to let the Soviet Union have unconditional and unrestricted most-favoured-nation treatment. The Soviet Union, for its part, would consider itself affronted and discriminated against if it were to apply for adoption as a member of the General Agreement on Tariffs and Trade without being assured of receiving, *de jure*, unrestricted most-favoured-nation treatment from all the non-socialist countries represented (many Western countries do grant it such treatment *de facto*). Full most-favoured-nation status in the event of joining GATT is a highly political question of prestige for the USSR, so it is hardly surprising that, after the rejection of its unofficial application to be recognised as an observer was rejected in 1982, it felt that it had been snubbed, by the USA in particular.

This unsuccessful attempt to attain observer status may well prove to be the last Soviet approach towards GATT for many years to come. On top of that, the nature of the GATT membership actually granted to the four CMEA countries now participating represents a wedge between GATT and the USSR, for these countries do ultimately have inferior rights. The reticence shown by East Germany can certainly be attributed to a great extent to its faithful allegiance to its CMEA partner, the USSR. However, it is all the easier for it to show this political allegiance when one considers that, via inner-

³ Cf. P. Pissulla: Internationale Organisationen (UNCTAD, GATT, IWF, Weltbank), in: R. Rode and H.-D. Jacobsen (eds.): Wirtschaftskrieg oder Entspannung?, Bonn 1984, p. 255 f.

German trade which makes it a quasi-member of the European Community, it already has more benefits with regard to major Western industrial nations than it could ever obtain from the most-favoured-nation principle.

GATT Membership Unsatisfactory

How unsatisfactory GATT membership is for those socialist countries which actually joined will be apparent from the events briefly described below.⁴ The USA initially denied most-favoured-nation treatment to all socialist countries except Poland and Yugoslavia under the terms of the Trade Expansion Act of 1962 and of Art. XXXV of the GATT agreement. Even the passing of the Trade Act of 1974 did not – as GATT's Eastern European members had hoped – force the USA into a position where it would have to concede unrestricted most-favoured-nation status to them. It was not until bilateral trade agreements were reached that Romania and Hungary received most-favoured-nation treatment on a limited basis. Moreover, the principle's application was further restricted by the Jackson-Vanik Amendment, which makes the granting of trade preferences conditional upon a more liberal attitude by their governments towards citizens wishing to emigrate. Both countries concerned felt that they were being discriminated against by being given this special treatment which they criticised vehemently.

⁴ Cf. P. Pissulla, op. cit., p. 255 ff.

The provisions on annual import increases agreed between GATT and both Poland and Romania instead of tariff reductions has come to be a substantial burden for these countries. Their dilemma arose when they were forced to drastically reduce imports from the West because of the pressure generated by their high indebtedness and because of their limited ability to export to the West, leaving them in clear breach of their promise to GATT to increase their imports.

The United States therefore threatened Romania at the beginning of 1983 with the withdrawal of its most-favoured-nation status by pointing out that the country had acted contrary to its GATT agreement. In a normal situation, i.e. if Romania's membership of GATT had been based on mutual tariff reductions, it would undoubtedly have been able to resort to measures under Art. XII to curtail imports, especially as this was among the demands made by the International Monetary Fund in connection with a stand-by credit agreement to consolidate Romania's balance of payments. The only reason the withdrawal of most-favoured-nation treatment did not eventually go through was that Romania declared its willingness to revoke emigration regulations for Romanian citizens of which the USA had disapproved.

The USA's treatment of Poland in October 1982 in the wake of threats of an embargo was still sterner: most-favoured-nation status actually was withdrawn, resulting

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in clearly discernible export losses for Poland in its US trade. Although the American action was politically motivated, the line of argument actually used was, once again, that Poland had not met its obligation to import as agreed with GATT since 1978. In 1984 the USA again justified its withdrawal of most-favoured-nation treatment for Poland with the observation that it did not expect Poland to be able to meet its import obligations within the foreseeable future.⁵

An Appropriate Stimulatory Instrument?

To conclude this commentary, we return to the central question of the extent to which it is justifiable to expect that the membership of state-trading countries in GATT could effectively intensify East-West economic relations.

As has already been established, the fundamental concepts upon which GATT is based bear the undeniable hallmark of the free market economic system. Basically, the trading system of the GATT countries, shaped as it is according to free market principles, rules out the inclusion of state-trading countries. For the fact is that state-trading countries, both by their nature and as a consequence of the underlying principles guiding both the domestic and foreign sectors of the economy, are not in a position to provide a truly equivalent reciprocal concession to the other GATT countries by creating suitable benefits for them in return for the advantages accruing from most-favoured-nation status.

Trade Concessions of Unequal Value

It can only be possible for state-trading countries to become members of GATT if the remainder of the GATT community is willing to seek compromise solutions, as far as both the quality and the quantity of trade concessions to be made by the socialist countries seeking admission are concerned. Whenever unequal partners come together, pragmatic solutions are needed in which it is impossible to rule out certain imbalances. If trade concessions in the form of particular quantitative obligations to import are made on the Eastern side, a closer examination of what is involved shows that there can hardly be any question of the trade concessions granted being on a par with each other. Indeed, no method of assessment has emerged to date for giving any convincing indication of the equivalence of most-favoured-nation treatment on one side of the balance set against obligations to import on the other. Rather,

there is a great deal to indicate that the compromise solutions involved are not equal on both sides.⁶

□ Most-favoured-nation treatment provides the socialist countries with the opportunity to become active in whichever of the partner countries they may choose, making use of the tariff advantages now granted to them, and to do so in virtually all market areas with the exception of a very few products which remain protected by quotas. Because of the principle of non-discrimination, a socialist country no longer need have any fear of facing different treatment from individual countries. The export volume which can be achieved by the country's own activity in the GATT partner countries can amount to several times the volume pledged in import obligations.

□ Apart from the question of equivalence, the remaining GATT countries also face the problem of how the import volumes promised by the socialist countries will be shared out among the different Western companies from various Western countries wishing to supply them.

□ Western companies also face an unequal situation in that they are unable to enter into the socialist markets and, by canvassing these markets, to exert a substantial influence on the socialist partner's import structure; they can only do business within the framework of the import structures set down within the Eastern partner's national economic plan.

The scope for action socialist countries receive upon entry into GATT, then, is almost unrestricted, but they do not concede the same sort of access to their new partners. Compared with their counterparts in GATT, the socialist countries thus have clear qualitative and structural advantages. Whereas a socialist supplier entering foreign markets does not have to assert itself against the opposition of either a free-enterprise or a state monopoly, Western entrepreneurs seeking entry into a socialist country are virtually up against the state itself, for it can model the structure of imports according to economic and/or political criteria which suit its own purposes and, furthermore, exerts a direct influence upon the choice of suppliers from individual countries. To put it yet another way: the Western entrepreneur cannot rule out the possibility that the considerations of, and actions taken by, the Eastern partner which are of crucial significance when contracts are granted are not of an economic but of a political nature – and may discriminate against him. Socialist countries, too, are required to make the promise that they will not discriminate against their GATT partners in trade relations; whether they really act according to their word

⁵ Cf. GATT: GATT Activities in 1984, Geneva 1984, p. 53.

⁶ Cf. H. Gröner, *op. cit.*

generally remains an open question, as in the majority of cases it is impossible to prove that the prohibition on discriminatory practices has been violated.

Within GATT, the Western countries renounce many of the instruments they could use to control their trade with the socialist countries, whereas any of the latter joining as new members are able to continue using the full range of decision-making competence when it comes to the volume and structure of their trade and to the choice of trading partner. Given that any compromise reached if a socialist member is admitted to GATT ultimately constitutes a breach of the fundamental principle of reciprocity, the policy of expanding GATT to include all the socialist countries can hardly be a high-priority goal for the organisation.

Restricted Rights for Socialist Countries

Yet from the socialist countries' point of view, too, GATT has never been regarded as an optimal concept for regulating their trading relations with other countries which have non-socialist economic systems. To add to this, the socialist members of GATT have come to realise in recent years that the most-favoured-nation status they have been granted is not guaranteed in the same way as that of other member countries. While, for example, Western countries (the relatively small ones in particular) are able to feel that they are properly protected by the most-favoured-nation clause against discriminatory infringements made by any of their partners, the socialist countries have all too real a fear that, because of the desire to protect certain markets in Western countries, they will get involved in investigation proceedings (regarding pricing policy) which may then result in the erection of new import barriers in the form of quotas. In short, the socialist countries only really benefit from most-favoured-nation status in a restricted sense, even if that restriction is an understandable one in principle given the lack of reciprocity on the part of the

Eastern countries in providing suitable trading conditions.

The events involving Poland and Romania discussed earlier make it clear that socialist countries cannot necessarily build on the basis of the most-favoured-nation clause – even in a restricted form – being honoured by all of their Western GATT partners. Even though the USA was able to justify its suspension of most-favoured-nation treatment for Poland on the basis of an undisputed legal right, the action nevertheless unequivocally contravenes the spirit of GATT. It is unlikely that any other economy would have been punished in such a way if, in a comparable emergency situation, it had introduced restrictions on imports in the interests of economic stability. It is a point of fact that the compromise solutions on the basis of which socialist countries have been admitted to GATT do not provide those countries with the same legal basis in concrete situations as that which is available to the other GATT members who joined via the normal mutual granting of most-favoured-nation status.

Because the socialist countries are unable to offer their Western counterparts most-favoured-nation treatment in full, and on a completely equal basis, GATT tends to appear unsuitable as a regulatory mechanism to apply to worldwide economic relations. From the outset, any compromise solution carries the makings of unequal treatment for the socialist countries by the other member states, with all the implied danger for the future development of mutually advantageous economic interchange. All in all, it is an unavoidable conclusion that GATT, at best, can offer no more than an interim solution in the consolidation and intensification of East-West economic relations. The possibility of extending East-West trade via a free trade zone encompassing the whole of Europe, which has been in discussion recently, must be viewed with similar scepticism.

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